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MEET YOUR MAN THE MANAGER

NATIONAL TEA CO.

ANNUAL REPORT

1966

MEET YOUR MAN THE MANAGER

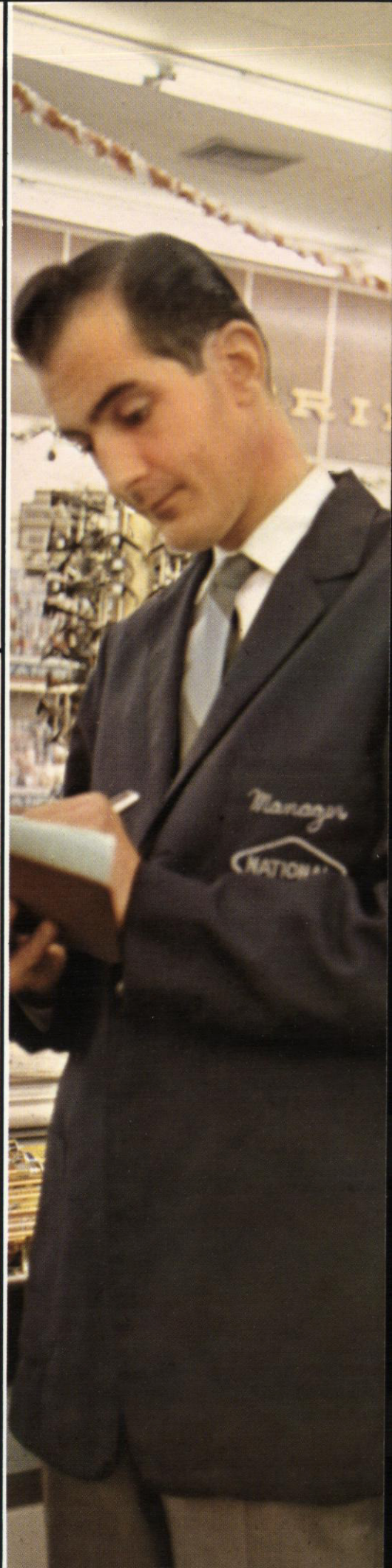
He is an important link in the National chain. He has leadership, know-how, experience, responsibility, personality and drive. He has to have these managerial qualities in full measure because, as a store manager, he's the man in charge of a business with average annual gross sales of $1,500,000.

Working closely with company management, the store manager is making a strong contribution to National's operation. His link is vital in the chain leading from producer to consumer.

Think of the National store manager as a "key man" whose primary goal is making good in a big way for the company, for the shareholders and for himself. He is the highly-trained commander of troops on the "selling" line. In today's competitive market, his job is without parallel in the commercial world. He's a specialist in every line of merchandise carried by National—a good man to know, as he can be considered a personal representative of the company's shareholders.

The typical National manager has made a great record for himself and the company. Most National executives have risen through the ranks. Many started their supermarket careers as stock boys and advanced to store manager on their way to earning divisional and nationwide responsibilities.

Additional information about the National store manager is presented in later pages of this report. It will give you a better understanding of his capabilities and responsibilities as your commander on the "selling" line.



A MAN WITH A BIG JOB AND A BRIGHT FUTURE

Please the customers by serving them courteously and helpfully with the merchandise they want! That, in a nutshell, is the goal of the National store manager. He can . . . and does . . . accomplish this with the help of others—store personnel, his division manager and the various National specialists who are constantly on tap with effective advertising, sales promotion and merchandising programs tailored to today's customers and their wants.

As an indispensable man on National's merchandising team, he plays an important role in the competitive battle for sales and profits. His, indeed, is a big job with a bright future. The National store manager is a man on the "go." He can't just run in place, but must have the inspiration, nerve and determination to forge ahead and build his customer clientele on a broad base of service and quality. He's a rising young man. Some day he may be a department head of National, or maybe its president or board chairman.

Right now he's a master merchandiser in the world's most competitive business. Knowing his customers and keenly aware of their buying preferences, he has the know-how to satisfy them and retain their patronage, week after week.

With progress uppermost in his mind, the National store manager works hard and with dedication to protect his investment in the future. In doing so, he is looking out for the interests of the shareholders by building patronage, gross sales and profits.

Keep your eye on the National store manager. Get acquainted with him in your community, because of his vital position in the National picture. Next year he may be in a higher supervisory position, because of his outstanding performance in sales, service and profits. But there'll be another trained and eager young man taking his place, stepping into the fast pace to keep strong what he knows is an important position in National's network of food stores. Your management takes pride in every store manager. We are pleased to help you know him better.

1966 CONSOLIDATED BALANCE SHEET

ASSETS

	December 31, 1966	January 1, 1966
CURRENT ASSETS:		
Cash	$ 15,849,893	$ 13,174,939
Accounts receivable	7,314,955	6,774,915
Inventories, at lower of average cost or market	83,422,574	90,503,841
Prepaid expenses, etc.	4,355,777	4,999,126
Real estate in process of development and sale	1,493,507	2,098,563
Total current assets	$112,436,706	$117,551,384
OTHER ASSETS	$ 2,401,200	$ 1,563,499
PROPERTY AND EQUIPMENT, at cost:		
Land	$ 2,929,324	$ 2,902,201
Buildings	10,296,686	10,197,624
Fixtures and equipment	109,131,008	111,645,273
Reserves for depreciation	(55,672,392)	(54,415,562)
Leasehold improvements, less amortization	21,792,792	22,223,415
	$ 88,477,418	$ 92,552,951
Unamortized excess of cost of investment in divisions and subsidiaries over underlying book values at dates of acquisition	906,292	928,792
	$ 89,383,710	$ 93,481,743
	$204,221,616	$212,596,626

The accompanying notes are an

NATIONAL TEA CO. & SUBSIDIARIES

LIABILITIES

	December 31, 1966	January 1, 1966
CURRENT LIABILITIES:		
Current maturities of long-term debt	$ 3,086,000	$ 1,566,000
Accounts payable	35,405,696	42,817,300
Accrued liabilities	7,706,959	7,907,074
Federal income taxes	8,561,187	2,229,907
Total current liabilities	$ 54,759,842	$ 54,520,281
LONG-TERM DEBT:		
Installment mortgage notes on store buildings	$ 641,274	$ 697,901
3½% promissory notes, due serially to 1969	172,000	258,000
4% promissory notes, due serially to 1973	7,800,000	8,800,000
5% sinking fund debentures, due 1977	7,680,000	8,160,000
5¼% note, due in installments to 1971	7,000,000	—
4¾% term note, due 1967	—	5,000,000
3½% subordinated debentures, due 1980	2,465,000	2,465,000
	$ 25,758,274	$ 25,380,901
OTHER LIABILITIES:		
Deferred Federal income taxes	$ 5,424,500	$ 5,646,000
Self-insurance	390,000	390,000
	$ 5,814,500	$ 6,036,000
SHAREHOLDERS' INVESTMENT:		
Common shares, $4 par value, authorized 10,000,000 shares; issued 8,754,688 shares (8,750,413 in 1965)	$ 35,018,752	$ 35,001,652
Paid-in surplus	30,803,217	30,761,001
Earned surplus	67,036,024	62,919,888
	$132,857,993	$128,682,541
Less cost of 909,632 common shares in treasury (118,437 in 1965)	14,968,993	2,023,097
	$117,889,000	$126,659,444
	$204,221,616	$212,596,626

integral part of this statement.

STATEMENTS OF CONSOLIDATED INCOME AND SURPLUS

	FISCAL YEAR ENDED	
	December 31, 1966	January 1, 1966
INCOME:		
SALES	$1,190,494,686	$1,161,948,193
COSTS AND EXPENSES:		
Cost of sales, occupancy, buying and other operating expenses	$1,033,533,838	$1,008,331,891
Selling, general and administrative expenses	136,456,009	131,813,343
Interest expense, net	1,149,064	1,315,769
Profit sharing	548,000	596,000
Federal income taxes	7,946,000	8,575,000
	$1,179,632,911	$1,150,632,003
NET INCOME	$ 10,861,775	$ 11,316,190

EARNED SURPLUS:	
BALANCE AT JANUARY 1, 1966	$ 62,919,888
ADD (DEDUCT):	
Net income	10,861,775
Dividends ($.80 per share)	(6,745,639)
BALANCE AT DECEMBER 31, 1966	$ 67,036,024
PAID-IN SURPLUS:	
BALANCE AT JANUARY 1, 1966	$ 30,761,001
Excess of proceeds over par value of common shares sold to officers and employees under stock option plan	42,216
BALANCE AT DECEMBER 31, 1966	$ 30,803,217

The accompanying notes are an

CONSOLIDATED STATEMENT OF SOURCE AND DISPOSITION OF FUNDS

	FISCAL YEAR ENDED	
	December 31, 1966	January 1, 1966
SOURCE OF FUNDS:		
Net income	$10,861,775	$11,316,190
Non-cash items deducted in arriving at net income:		
Depreciation and amortization	13,826,694	13,575,019
Deferred Federal income taxes	(221,500)	51,000
Total funds from earnings	$24,466,969	$24,942,209
Proceeds from sale of common shares to optionees	59,316	381,580
Proceeds from 5¼% note issued (net of retirement of 4¾% note in the amount of $5,000,000)	5,000,000	—
Proceeds from sale of fixtures and equipment in 62 Detroit area stores	3,034,157	—
Decrease (increase) in working capital	5,354,239	(1,301,904)
Total	$37,914,681	$24,021,885
DISPOSITION OF FUNDS:		
Cash dividends to shareholders	$ 6,745,639	$ 6,774,302
Net additions to property and equipment	12,785,318	14,069,664
Maturities of long-term debt	4,622,627	5,524,729
Less conversion of 3½% debentures	—	(3,742,000)
Acquisition of treasury shares	12,945,896	1,231,719
Transfer from deferred to current income tax reserves	—	290,000
Other dispositions (sources), net	815,201	(126,529)
Total	$37,914,681	$24,021,885

integral part of these statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Long-Term Debt

Aggregate maturities and sinking fund requirements under long-term loan agreements, exclusive of minor installments due on store building mortgage loans are $3,086,000 in 1967, $3,566,000 in 1968 and 1969, $3,480,000 in 1970, and $2,480,000 in 1971.

Dividend Restriction

Under the terms of the indenture securing the 5% Sinking Fund Debentures, $40,699,404 of earned surplus is restricted as to the payment of cash dividends on and the purchase of common shares at December 31, 1966. In addition, the company must maintain a current ratio of consolidated current assets to consolidated current liabilities as defined in the indenture of at least 2 to 1. As of December 31, 1966, the current ratio as defined was 2.3 to 1.

Stock Options

As of December 31, 1966, there were 57,555 unissued common shares reserved for options. All of such options were exercisable at that date at $13.875 per share. Each option under the Plan expires four years after date of grant, but not later than January 1, 1968. These options may be exercised in whole or in part at any time until expiration of the options on December 23, 1967.

Legal Proceedings

In March, 1959, the Federal Trade Commission filed a complaint against the company alleging that several acquisitions of additional retail grocery stores violated Section 5 of the Federal Trade Commission Act and Section 7 of the Clayton Act. On March 4, 1966, the Federal Trade Commission issued its order providing that for a period of ten years, the company shall not, without prior approval of the Commission, directly or indirectly acquire the whole or any part of the stock or assets of any firm, partnership or corporation engaged in the retail sale of food products. Such proceeding has been terminated as the company elected not to appeal the order.

Disposition of Stores

During the year the company sold, substantially at book value, 62 stores located in the Detroit area. These stores had sales in 1965 of approximately $80,000,000.

Lease Commitments

At December 31, 1966, the company and its subsidiaries had 686 leases expiring more than three years after that date (some of which contain percentage rental clauses) with minimum annual rentals amounting to approximately $18,100,000 exclusive of taxes, insurance and maintenance payable by the lessee. Of this amount, approximately 55% applies to leases expiring within 10 years.

AUDITORS' REPORT

ARTHUR ANDERSEN & CO.

69 West Washington Street
Chicago, Illinois 60602

TO THE SHAREHOLDERS,
NATIONAL TEA CO.:

We have examined the consolidated balance sheet of NATIONAL TEA CO. (an Illinois corporation) AND SUBSIDIARIES as of December 31, 1966, and the related statements of consolidated income and surplus and source and disposition of funds for the fifty-two weeks then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying consolidated balance sheet, statements of consolidated income and surplus and source and disposition of funds present fairly the financial position of National Tea Co. and Subsidiaries as of December 31, 1966, and the results of their operations and the sources and disposition of funds for the fifty-two weeks then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding fifty-two week period.

ARTHUR ANDERSEN & CO.

Chicago, Illinois
February 10, 1967

DIRECTORS

JOHN F. CUNEO
President of
The Cuneo Press, Inc.

EDWARD L. JONES
Vice President, Secretary and
Treasurer of George Weston Limited

RICHARD G. MEECH
Vice President, Secretary and
Treasurer of Loblaw Companies
Limited

GEORGE C. METCALF
Chairman of the Company,
President of George Weston Limited
and Loblaw Companies Limited

W. STRUAN ROBERTSON
Partner, Borden, Elliot, Kelly
and Palmer

NORMAN A. STEPELTON
President and Chief Executive
Officer

CLAUDE H. WEBSTER
Executive Vice President

W. GARFIELD WESTON
Chairman of the Board of
George Weston Limited

OFFICERS

GEORGE C. METCALF
Chairman of the Company

NORMAN A. STEPELTON
President and Chief Executive Officer

CLAUDE H. WEBSTER
Executive Vice President–Operations

VICE PRESIDENTS

GEORGE E. HOUSTON
Regional Operations

J. E. LAUGHLIN
Regional Operations

FRANK E. LINQUIST
Regional Operations

RODGERS N. BROWN
Regional Operations

WILLIAM H. LOWMAN
Meat Operations

HAROLD L. WILKENS
Produce Operations

ROBERT S. KLEGON
Drug Operations

H. L. MARTIN
Personnel

WILLIAM J. LEDERER
General Counsel

J. P. QUIRK
Labor Relations

G. W. MAXWELL
Real Estate

JAMES E. COLLOTON
Warehousing & Transportation

ROBERT E. SWAIN
Store Planning & Equipment

NAT MALT
Division Manager

GORDON A. SEEBERG
Division Manager

Secretary-Treasurer
ALLAN WILSON, JR.

Comptroller
E. C. WINLAND

HOME OFFICE
1000 N. Crosby Street
Chicago, Illinois 60610

DIVISIONAL OFFICES AND WAREHOUSES
Chicago • Minneapolis • Milwaukee
Indianapolis • St. Louis
New Orleans • Memphis
Davenport • Denver • Sioux City
Youngstown

TRANSFER AGENTS
The First National Bank of Chicago,
Chicago, Illinois
The Chase Manhattan Bank,
New York, New York

REGISTRARS
Continental Illinois National Bank
& Trust Company of Chicago,
Chicago, Illinois
Chemical Bank New York Trust
Company, New York, New York

TRANSFER AND PAYING AGENTS
3½% Debentures
Chemical Bank New York Trust Company
New York, New York
5% Debentures
Morgan Guaranty Trust Company
New York, New York

★ ★ ★
NATIONAL
TEA CO.

FINANCIAL HIGHLIGHTS

FOR THE FISCAL YEAR ENDED:	December 31, 1966	January 1, 1966	January 2, 1965 (53 weeks)	December 28, 1963	December 29, 1962
Sales	$1,190,494,686	$1,161,948,193	$1,122,515,806	$1,056,919,339	$979,049,258
Income before Federal income taxes	18,807,775	19,891,190	20,346,294	16,890,546	18,123,011
Federal income taxes	7,946,000	8,575,000	9,706,000	8,526,000	9,005,000
Special credit, net of taxes	—	—	—	840,710	—
Net income and special credit	$ 10,861,775	$ 11,316,190	$ 10,640,294	$ 9,205,256	$ 9,118,011
Percent to sales	.91%	.97%	.95%	.87%	.93%
Per share*	1.32	1.32	1.25	1.17	1.28
Dividends per share	.80	.80	.80	.80	.80
AT YEAR END:					
Working capital	$ 57,676,864	$ 63,031,103	$ 61,729,199	$ 57,425,117	$ 58,550,701
Property and equipment	89,383,710	93,481,743	92,987,098	94,905,503	92,242,459
Long-term debt	25,758,274	25,380,901	30,905,630	32,531,023	33,607,132
Shareholders' investment	117,889,000	126,659,444	119,227,040	116,159,100	113,783,457
Shares outstanding	7,845,056	8,631,976	8,483,152	8,525,815	7,161,942
Book value per share	15.03	14.67	14.05	13.62	13.35
Supermarkets in operation	865	941	973	986	985

*Based upon average of number of shares outstanding at beginning and end of year.

To Our Shareholders:

The year 1966 was a record-breaking year for almost every sector of the American economy, but it did present the retail food industry with some of the problems of inflation – increased wages, higher expenses, tight money rates and a generally rising cost spiral. The consumer boycott activity in the latter part of the year, which was essentially a general protest against inflation, had its most serious effect on retail food stores. As a result of this combination of factors, earnings for the fourth quarter did not maintain the record-breaking level of the interim earnings of the first three quarters of the year.

Despite the sale of 62 stores in the Detroit area, sales for the year ended December 31, 1966, were $1,190,494,686, an increase of 2.5% over the previous high of $1,161,948,193 recorded in 1965. If 1965 sales were to be adjusted to reflect the disposition of these stores, our sales increase would have been 6.8%.

Net income after taxes was $10,861,775, equal to $1.32 per share as compared with $11,316,190 and $1.32 per share in 1965. Earnings per share are based upon an average of 8,239,000 shares outstanding during the year, a reduction of 319,000 shares from the average outstanding during the year 1965. This reduction resulted from our solicitation of invitations to tender stock for the Company treasury, which was concluded August 25, 1966. The Company purchased 758,984 shares at the offering price of $16.00 per share, increasing its treasury holdings to 909,632 at year end.

Federal Trade Commission Proceedings

On March 4, 1966, the Federal Trade Commission issued an order requiring the Company for a period of ten years to obtain its prior approval before directly or indirectly acquiring the whole or any part of the stock or assets of any business engaged in the retail sale of food products. It was the decision of the management of the Company not to appeal this order, thus ending almost 10 years of litigation, which was very costly in terms of both expenses and management time.

It should be noted that this order does not prohibit the Company from acquiring other types of retail stores, nor does it interfere in any way with Company plans for continued internal growth by improving existing stores or opening additional stores in present operating areas or new markets; nor does it prevent diversification into related fields.

Growth Through Improvement of Stores

In 1966, 28 stores were opened; 15 were new locations and 13 were relocations of older stores. In addition,54 stores were enlarged or remodeled at a total fixed asset outlay of $2,917,500,or an average of $54,000 per store. Some of these remodeling or enlargement projects were undertaken as an alternative to relocations due to the fact that high interest rates and sharply increased construction costs made it extremely difficult to secure the desired number of new locations at reasonable rentals.

Total expenditures for all capital improvements were $12,785,318, including new and remodeled stores, warehouse and transportation replacements and additions.

Disposition of Stores

The Company had 865 stores in operation at the close of the fiscal year, 76 fewer than at the beginning of the year. 62 stores in the Detroit area were sold during the year, and the Detroit warehouse and office were closed, along with the meat packing plant in Port Huron, Michigan, which formerly served the Michigan stores. Sales generated in 1965 by the 62 stores sold were approximately $80,000,000.

As indicated in my letter to the shareholders earlier this year, it was the decision of management to recoup our investment in this area, in view of the prospects for little more than a marginal return in the foresee-

able future. The sale of these assets was substantially at book value, and no gain or loss was incurred.

Scholarship Program

The Company's continuing interest in its employees is highlighted by the inauguration in 1966, of the new College Scholarship Program for full-time and part-time employees and children of employees. The purpose of the program is to encourage the younger members of our organization who are graduating from high school, or currently enrolled in college, to continue their education.

More than 100 scholarships worth a total of $65,000 will be awarded in April, 1967. The scholarships range in value from $250 to $1,000, and will be awarded on a competitive basis. Winners will be selected solely on the basis of ability. Once selected, the amount of each scholarship will be determined through a careful evaluation of each individual's family financial situation. Winners may attend any accredited college or university in the United States.

We expect our scholarship program to be a contributing factor in the future success of many young men and women working for the Company today, and we hope their success will be at National—as future leaders of the Company.

Kare Drug Operations

The expansion of Kare Drugs proceeded according to plan during the year. By year-end there were 43 Kare Drug departments in operation in 7 of our retail divisions. Results in these units to date have proven the excellent customer acceptance of this combined merchandising concept, and the number of these units will be further expanded in 1967.

Organizational Changes

The entire organization was saddened by the passing on December 22, 1966, of Mr. Harley V. McNamara, who served our Company as a director from 1945 to 1965, as President from 1946 to 1961 and as a Consultant from 1961 until his retirement in 1966. Mr. McNamara was widely known and well respected as a leader in the food industry, and will be missed by all who knew him.

Just prior to the close of the year, Mr. N. L. Chaplicki, Executive Vice President–Administration, announced his retirement. Mr. Chaplicki had a long and distinguished career in the retail food industry and with National. He had served as a director of the Company from 1957 until his retirement.

Mr. F. E. Linquist, a Regional Vice President, has taken over most of the functions formerly assigned to Mr. Chaplicki.

To succeed Mr. Linquist in regional operations, Mr. Rodgers N. Brown, formerly Vice President in charge of the New Orleans Division, has been appointed a Regional Vice President.

Mr. H. L. Wilkens, Vice President, has been granted a leave of absence for medical reasons. Mr. Marvin E. Cross, formerly a divisional produce operator, has been named Director of Produce Operations.

Retail Food Industry

The retail food industry, of which National has been a leader for more than 60 years, has a great record of achievement in putting food on the American dinner table at low prices, a record of which we are justly proud. Judging from the events of the past several months however, it is quite evident that the food industry has failed to make the consuming public aware of these achievements. The amount of income spent for food today is at an all time low of 18.2% of disposable income as compared with 26% in 1947. This 18¢ of each dollar spent for food covers a larger variety of products with much more convenience and value for the home-maker than ever before in history.

A Look Forward

The long range outlook indicates the likelihood of rising food prices in the year ahead. Our success in 1967 and beyond, will depend in large measure upon our ability to offset rising food costs and increased operating expenses by means of higher sales volume, adequate profit margin, and the aggressive, continuous search for greater operating efficiencies throughout our organization. We know that we have the skills, energy and resources to move steadily forward in our plan of growth and expansion. We are confident that, no matter what the economic climate, we will continue to broaden the base of our achievements in 1967.

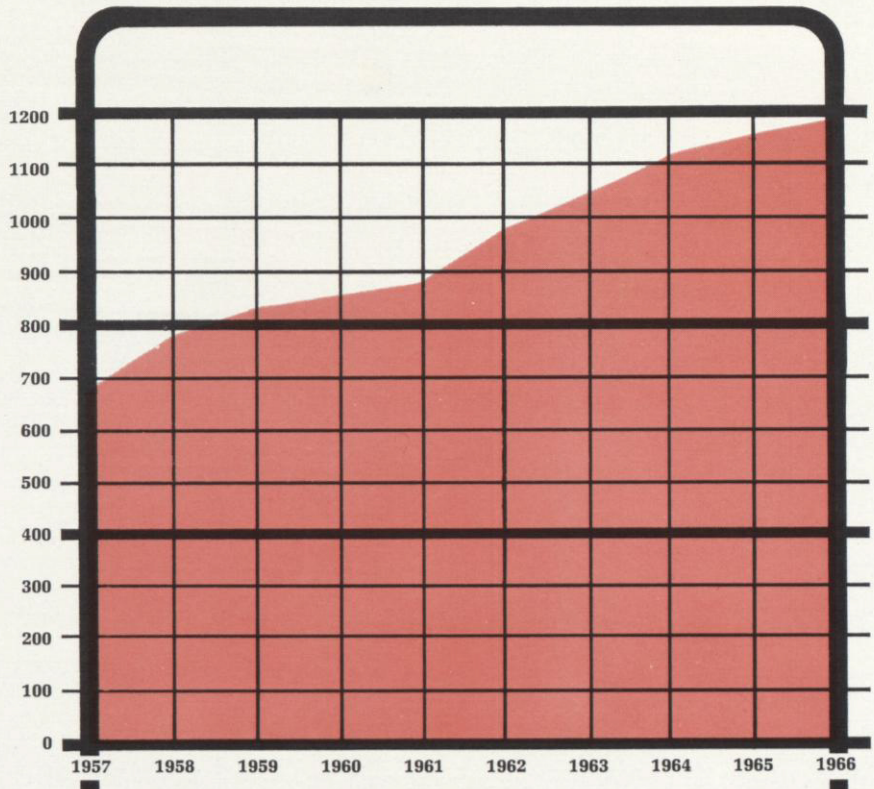
President

Chicago, Illinois
February 10, 1967

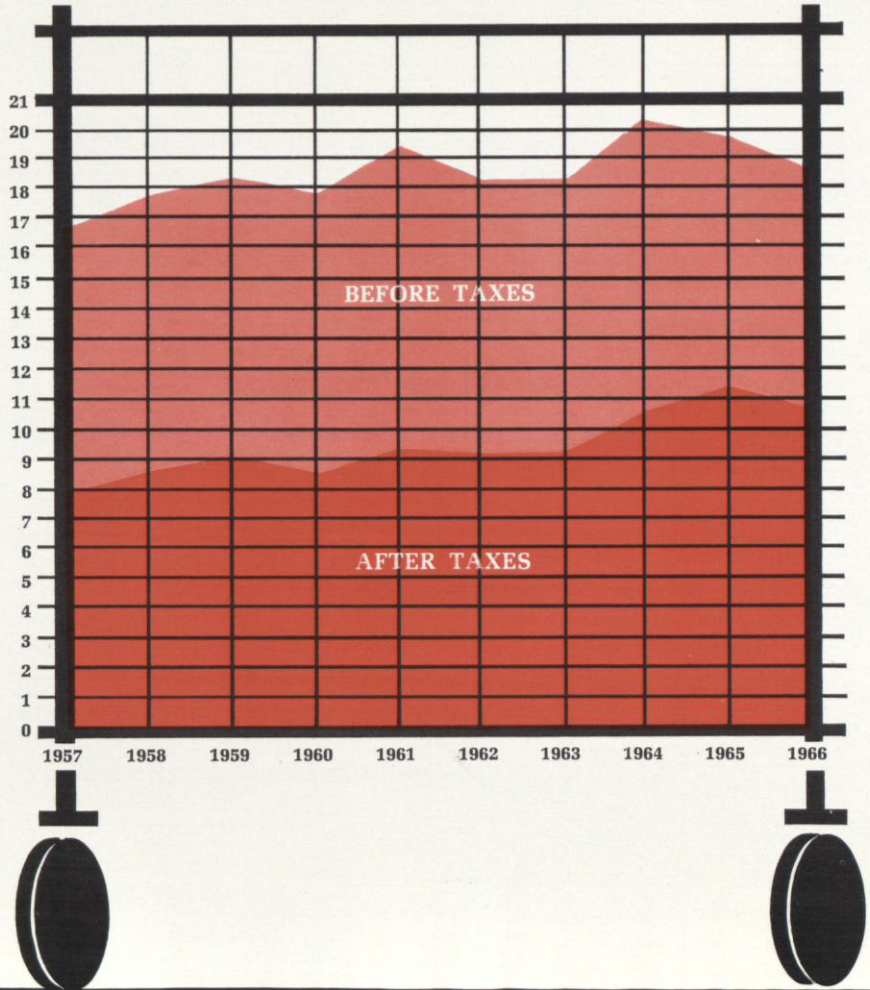
1966 Distribution of the Sales Dollar

Cost of Merchandise Sold	79.53%
Wages & Benefits	12.51
Rents, Repairs & Depreciation	3.58
Other Expenses	2.29
Taxes	1.17
Dividends	.57
Retained Earnings	.35

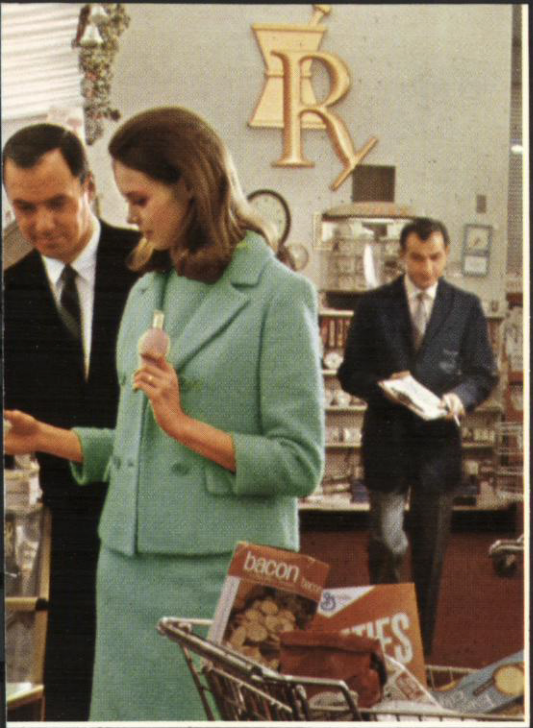
10 YEAR SALES TREND
(In Millions)

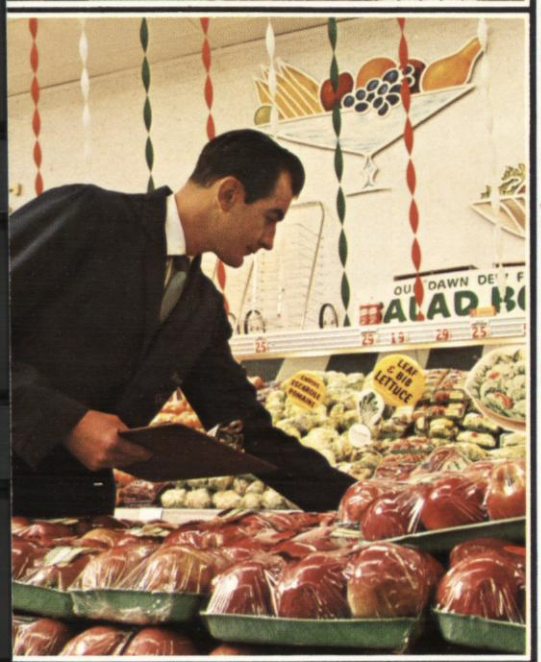


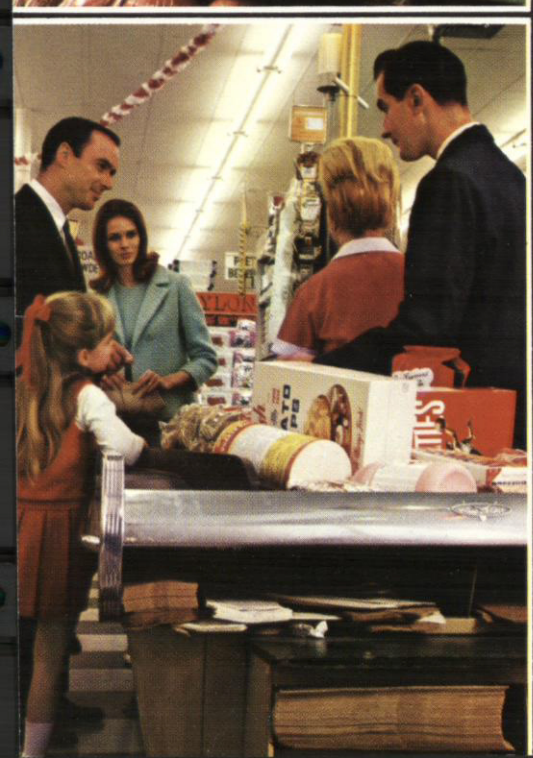
10 YEAR PROFIT TREND
(In Millions)



Daisys
Daisys







THE MAN WITH YOUR INTERESTS IN MIND

The typical National store manager, above all, is human. He owns shares in his company, has a family with an average of three children, drives a popular make automobile, belongs to a church or synagogue and takes part in community activities as time allows.

He "is" National Tea in his trading area—a dedicated local merchant, who lives in, understands and works with the community. He is well qualified to serve the particular needs of the area served by the National Food Store which he manages.

National is foremost in his mind. To that end, he works long hours and gives on-the-job training to other promising young men and women. He has prepared himself in basic education, the better to serve National, the shareholders and his own opportunities for advancement. He is taking, or has completed, one or more of the Home Study courses in food distribution and management.

To become a store manager, he first has to complete the Management Development Program, available to selected assistant store managers. This program consists of courses in leadership development and operational training spread over a nine-month period.

Youth is an asset, too. Sixty-one per cent of National store managers are in the age bracket 23-39. The median age is 35 years. Youthful energy, ambition and imagination are harnessed in the typical National store manager to produce the best possible overall results.

He typically has 27 qualified employees under his direction. His store has nearly 6,000 items and has thousands of customers. Your National store manager is a competent merchandiser. His is a complex, responsible job—one he handles with skill to the benefit of the company, to the shareholders and, of course, to himself and his family.

Cleveland Public Library
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Cleveland, Ohio 44114
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Business Information Dept